Risk Nexus

Income protection gaps: a rising global challenge

"Income protection gap – The reduction in household income as a consequence of the death or incapacitation of an adult wage earner on whom that household relies, taking all public and private sources of replacement income into account."
Zurich Insurance Group/Oxford Smith School, 2015

Loss of earned income, due to death or disability, can be devastating. Therefore, starting in the late 19th century, when a family's breadwinner no longer can put food on the table, compensation programs replace income lost. Today these programs encompass public schemes, private schemes and public-private partnerships. Unfortunately, these are increasingly failing to protect incomes. This creates what we call Income Protection Gaps (IPGs).

We found that a range of factors contributing to the challenge posed by IPGs. In the developed world, demand for government support – the traditional source of relief – is rapidly outpacing supply. Disability levels are increasing to ever more challenging levels, due both to an aging population and improved medical diagnosis. Yet public budgets, particularly after the global financial crisis (GFC), have failed to keep pace.

Western governments have cut back on protection largely by restricting access to benefits. To pick up the slack, governments look to private schemes. But in general, their uptake has been insufficient to fill the gap, partly owing to misperceptions of risk and the legacy of mostly generous government provisions. Meanwhile, an increasing proportion of workers have little or no income protection at all. Part-time and contract workers, whose numbers are rising, are excluded from most public income protection schemes, which are aimed almost exclusively at full-timers.

In the developing world, government schemes inherited from Europe seem set for similar difficulties. Average age is rising with growing prosperity, and numbers of casual, part-time, and temporary workers remain significant. Government funds are focused more on the impoverished and less on middle-earning workers, threatening to leave a burgeoning middle class exposed.

The impact of IPGs on households, governments, and employers is significant. Families risk falling into poverty. A U.S. study suggests two-thirds of impoverishment among surviving women and more than one-third among surviving men results from inadequate life insurance. Those with long-term disabilities face similar difficulties. Benefits are harder to come by, and returning to previous income levels is far from guaranteed. On average, self-identified disabled persons in the EU are 15 percent more likely to suffer poverty and/or social exclusion than non-disabled.

IPGs can also devastate retirement. With state support declining, families confronting IPGs are often forced to tap their pension savings. Given the global pension-savings gap, rising longevity, plus the declining generosity of pensions schemes, those affected by IPGs thus face a very real possibility of running out of money in their old age.

Employers are not immune from the negative impacts of IPGs. Growing gaps mean employees are increasingly vulnerable. For workers employed outside their home countries, public support is often highly problematic. But perhaps the main concern for employers is how IPGs hit productivity. Without adequate protection, and with job prospects much reduced for the disabled, many workers will choose to work through minor disabilities at reduced capacity. This 'presenteeism' will cost U.S. businesses more than USD 150 billion per year. Left unchecked, IPGs are likely to have a greater impact on productivity as workforces age.

IPGs will create a growing burden for governments in the future if not addressed adequately today. Most obvious is the demand for support created by premature death or disability, the latter of which will increase as populations age. In addition, labor market challenges faced by disabled workers will also reduce the volume and contributions of active workers who support social security funding. This adds to a much wider sustainability problem for the many welfare systems which rely on those of working age to sustain retirees. As explored for households, the depletion of savings to fill IPGs, combined with increased longevity, means those effected will again turn to the state for support in their later years. Added to all of this, the changing nature of the workforce threatens established welfare systems.

Even at this early stage, a number of areas for action are apparent. At the center of these is a need for collaboration. A global challenge such as IPGs is too big for the public or private sectors to tackle alone. Governments and employers are clearly important, but individuals should also take some responsibility for ensuring against gaps in income protection.

As such, a three-party approach is preferred, allocating responsibilities to each part of the system without overburdening the others.

Key approaches to consider include fostering global dialogue to raise awareness and spur action, tailored local approaches to reflect the diverse nature of IPGs, incentives through tax systems and a joint push to improve awareness among the general public.

Though employers clearly have a role to play in collaborative actions, they also have a unique opportunity to be a central player in solutions. We encourage them to also consider how income and life protection benefits can be used to retain and attract talent in today's ultracompetitive skills market, and how they might adapt working practices to counter IPGs in an aging workforce.

Several attempts have been made to measure IPGs on a global scale. We believe such estimates are useful but also problematic. The purpose of this report is not to provide exact numbers on IPGs. We instead seek to identify the trends that are aggravating the phenomenon, and challenge the traditional coping mechanisms that are in place. This report aims to raise awareness of IPGs' threat to households and to the public and private sectors. It also challenges us to consider some broad areas for action that we hope will stimulate thinking and debate, as well as providing insights for our own work in the next phases of this long-term project. Recognizing how widely IPGs vary, this study examines select countries across four geographic regions: continental Europe; the U.S., UK, Ireland and Australia; Latin America, and South Asia.

The full Risk Nexus report is available on knowledge.zurich.com/protection-gap/risk-vs-reality

Disclaimer

Zurich Insurance Company Ltd
Mythenquai 2
8002 Zurich
Switzerland

Chancellor Masters and Scholars of the University of Oxford.
Wellington Square
Oxford OX1 2JD
UK